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SUPREME COURT, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1959

NO. 85

RAYMOND J. FUNKHOUSER,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

R. J. FUNKHOUSER, ET AL., TRUSTEES,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

(Consolidated Cases)

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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(Consolidated Cases)

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fourth Circuit, Richmond, Virginia, entered in the above entitled consolidated cases on January 14, 1960.

OPINIONS BELOW

The opinion of the Tax Court of the United States (TC Memo 1958-222), sustaining in these consolidated cases the determinations of the Respondent, the Commissioner of Internal Revenue, of deficiencies in the gift taxes of the Petitioner, Raymond J. Funkhouser, for the years 1952 and 1953, is not officially reported. This opinion is printed in the Record (nine copies of which are filed herewith pursuant to Rule 21(4) of this Court) on Pages App. 8 to 17 thereof,[1] and is unofficialy reported as 17 TCM 1094. The judgment of the United States Court of Appeals for the Fourth Circuit, affirming the decisions of the Tax Court in favor of the Respondent, is printed in the Appendix hereto, Page 17, *Infra* and to date is not officially published.

JURISDICTION

The judgment for which review is here sought was rendered by the United States Court of Appeals for the Fourth Circuit on January 14, 1960, opinion by R. Dorsey Watkins, District Judge.

The jurisdiction of this Court is invoked under title 28 U.S.C., Section 1254.

QUESTION PRESENTED

The Petitioner, Raymond J. Funkhouser (hereinafter called the "Donor"), in the years 1948 through 1953 created seventeen trusts, one for each of his five children and one for each of his twelve grandchildren. In 1950, and from time to time thereafter, he also made additional gifts to

[1] The number of each page of the Record printed for the Court below and filed herewith is preceded by the letters "App.". The page references of the Record will be hereinafter designated by preceding the numbers thereof by the letter "R.".

those of the said trusts which were then in existence. For convenience, the following schedule, showing, in the order of the dates of creation of each trust, the name of the income beneficiary (the initial or primary beneficiary) thereof, the relationship of the beneficiary to the Donor, the date of birth of the beneficiary, date of creation of the trust for his or her benefit and the Record Exhibit number of said trust, is here set forth:

No.	Primary Beneficiary	Relationship	Date of Birth of Beneficiary	Date of Trust	Exh. No.
1.	Avis Fithian	Daughter	3/ 8 /12	12/17/48	1-A
2.	R. J. Funkhouser	Son	2/19/14	12/17/48	5-E
3.	D. F. Steeley	Daughter	10/16/17	12/17/48	10-J
4.	G. F. Smith*	Daughter	9/16/31	12/17/48	13-M
5.	J. F. Ashley*	Daughter	9/16/32	12/17/48	14-N
6.	Sandra Shupp	Granddaughter	11/24/32	12/17/48	2-B
7.	C. Funkhouser	Granddaughter	10/16/35	12/17/48	6-F
8.	R. J. Funkhouser	Grandson	5/29/39	12/17/48	7-G
9.	H. L. Rice, Jr.	Grandson	10/10/39	12/17/48	11-K
10.	A. C. Funkhouser	Granddaughter	1/ 3 /42	12/17/48	8-H
11.	W. T. Fithian	Grandson	12/ 1 /42	12/17/48	3-C
12.	Avis Fithian	Granddaughter	3/ 3 /45	12/17/48	4-D
13.	P. S. Funkhouser	Granddaughter	7/24/45	12/17/48	9-I
14.	D. S. Steeley	Granddaughter	12/19/45	12/17/48	12-L
15.	Wendy W. Wysong	Granddaughter	1/26/50	10/ 9 /50	16-P
16.	R. J. Funkhouser, II	Grandson	3/ 1 /51	10/25/51	18-R
17.	T. M. Evans	Grandson	6/21/53	10/ 1 /53	21-U

* On December 17, 1948, G. F. Smith was Geraldine F. Cain, and J. F. Ashley was Jacqueline F. Wysong (R. 10).

Under each of the said trusts, the respective beneficiary thereof was given the right to income for life and in reporting his gifts for the said years during the period 1948 through 1953, the Donor claimed an exclusion under Section 1003(b) of the Internal Revenue Code of 1939 for the present interest (the right to income for life) transferred

upon each gift in trust to the beneficiary of the respective trust. The Respondent, however, determined that the exclusions claimed by the Donor as aforesaid were not allowable in computing his net gifts for the years during the period 1948 through 1953.[2] The said determination by the Respondent was based solely on the reasoning that since the Trustees under each trust were given the power to invade the corpus thereof for the benefit of the income beneficiary, the right to income transferred immediately to such beneficiary did not constitute a present interest or was not subject to valuation if a present interest. As a result of his disallowance of the exclusions claimed by the Donor for the gifts in trust now in question, the Respondent determined deficiencies in gift taxes of the Donor for the years 1952 and 1953 in the following amounts:[3]

Year	*Deficiencies Determined*
1952	$9,411.43
1953	$2,013.34

The Tax Court of the United States sustained the aforesaid deficiencies determined by the Respondent on the sole ground that "the value of the interest in income cannot be determined in view of the power of the Trustee to termi-

[2] Although the Respondent determined deficiencies for the years 1952 and 1953, the amount of the Donor's net gifts for all prior years are here in question since the net gifts of a Donor for each year are taxable at rates on a graduated scale which takes into account the net gifts of all prior years.

[3] Due to the fact that the Statute of Limitations for the assessment against the Donor of additional gift taxes for the year 1952 had already expired at the time that the Respondent determined the aforesaid deficiencies, he determined on account of the aforesaid deficiency of $9,411.43 for 1952 a liability of $3,000.00 against each of sixteen trusts as Donee Transferee in 1952 of assets of the Donor in the said amount of $3,000.00. The Trustees of each of the aforesaid sixteen trusts are the other Petitioners herein.

nate that interest by distributing the corpus of the trust at any time * * *". In reaching these decisions the Tax Court erroneously stated that "distributions of corpus can be made for the benefit of individuals other than the primary beneficiary" notwithstanding that the trust instruments authorized the Trustees to make payments only to or for the benefit of the primary beneficiary and, as was correctly stated by the Tax Court of the United States elsewhere in its opinion, the references to needs of persons other than the primary beneficiary merely delineated the purposes for which such payments might be made to the primary beneficiary. The decisions of the Tax Court were affirmed by the United States Court of Appeals for the Fourth Circuit.

The question presented is:

Does the transfer of an interest to income for life from property which is transferred to a trust fail to qualify under the exclusion provision of Section 1003(b) of the Internal Revenue Code of 1939 merely because of the fact that the Trustees can make payments out of corpus to or for the benefit of the income recipient?

STATUTES WHICH THE CASE INVOLVES

The Sections of the Internal Revenue Code of 1939 which are here relevant are as follows:

Section 1001(a):

"The tax for each calendar year shall be an amount equal to the excess of—

(1) a tax, computed in accordance with the Rate Schedule hereinafter set forth, on the aggregate sum of the net gifts for such calendar year and for each of the preceding calendar years, over

(2) a tax, computed in accordance with the said Rate Schedule, on the aggregate sum of the net gifts for each of the preceding calendar years."

* * * * * *

Section 1003(a):

"General Definition. — The term 'net gifts' means the total amount of gifts made during the calendar year, less the deductions provided in section 1004."

Section 1003(b)(3):

"Gifts After 1942. — In the case of gifts (other than gifts of future interests in property) made to any person by the donor during the calendar year 1943 and subsequent calendar years, the first $3,000 of such gifts to such person shall not, for the purposes of subsection (a), be included in the total amounts of gifts made during such year."

STATEMENT OF THE CASE

This case arises from Petitions to the Tax Court of the United States for redeterminations pursuant to Section 6213 of the Internal Revenue Code of 1954 of deficiencies in gift taxes which were determined by the Respondent. The Notices of Deficiencies issued by the Respondent were all mailed to the Petitioners on March 4, 1957. All of the Petitioners filed Petitions in the Tax Court of the United States for redetermination of these deficiencies within ninety (90) days after such notices of deficiencies were mailed to them. The Tax Court rendered decisions against the Petitioners on December 31, 1958 and within ninety days thereof each of the Petitioners pursuant to Section 7482 of the Internal Revenue Code of 1954 filed in the Court of Appeals for the Fourth Circuit a Petition to review the said decision of the Tax Court.

Under the Federal Gift Tax Law, it is well settled that the unqualified right to receive for life or other periods of time is a present interest and not a future interest. *Elizabeth H. Fisher v. Commissioner*, 132 F. 2d 383 (C.C.A. 9, 1942); *F. J. Sensenbrenner v. Commissioner*, 134 F. 2d 883 (C.C.A. 7, 1943); and *Commissioner v. Brandegee*, 123 F. 2d 58 (C.C.A. 1, 1941) (T.C. Opinion, R. 15). The Re-

spondent agrees with this rule. See opinion of the Fourth Circuit, Appendix, *infra*, page 20. It is also well established that gifts in trust constitute gifts to the beneficiaries of the trust and not gifts to the Trustees and that the application of the Federal Gift Tax Laws is not dependent on the manner of making the gift or on distinctions between legal title and equitable title. *Helvering v. Mary V. Hutchins*, 312 U.S. 393; and *United States v. Arthur Pelser*, 312 U.S. 391.

Insofar as here relevant, all of the Trust Agreements pursuant to which the seventeen aforesaid trusts were created were identical in form. Each of the Trust Agreements provided in part as follows:

"Article Fifth

"1. * * * the Trustees shall collect the dividends and income from the trust fund, and after deduction of the expense of the administration of the trust, shall distribute and pay over the same forthwith as follows:

(a) to * * * (the particular named initial income beneficiary) for and during his (her) life; * * *

* * * * * *

"3. Notwithstanding anything herein to the contrary provided, the Trustees are authorized in their absolute discretion from time to time to pay over to or expend on behalf of any person who is an income recipient hereunder at the time, such sum or sums from the principal of the Trust as they shall deem necessary or advisable to provide for any illness or other emergency affecting such person who is an income recipient hereunder at the time or any member of his or her immediate family, or to provide for the care, maintenance, support or education of such person or any member of his or her immediate family."

(Exhibits 1-A to 14-N, 16-P, 18-R, 21-U; R. 53-94, 96-98).

All of the trusts were irrevocable (Exhibits 1-A and 2-B; R. 60, 69; T.C. Findings; R. 10).

The exclusion claimed by the Donor with respect to each of the gifts in trust here under consideration was an amount equal to the actuarial value of the right of the primary beneficiary to income for life from the principal amount of the gift, subject however to the statutory limitation that the amount of the exclusion claimed by the Donor in any one year with respect to any one trust would not exceed $3,000.00. For example, the gift made in 1948 to Trust 1-A for the benefit of Avis Funkhouser Fithian had a value of $6,655.00 (T.C. Findings; R. 11). In that said year, the Donor and his wife elected to have their total gifts for that year considered as having been made one-half by each of them pursuant to Section 1000(f) of the 1939 Internal Revenue Code (T.C. Findings; R. 11) and therefore on his gift tax return for the calendar year 1948, the Donor reported one-half of the value of that said gift to Trust 1-A of $6,655.00, or $3,327.50, in his total gifts. The present value of the right to income for life from the said amount of $3,327.50 was determined by multiplying that amount by the applicable percentage factor set forth in the life income valuation table approved by the Respondent in his Regulations and the valuation of the life income interest of Avis Funkhouser as so ascertained was claimed by the Donor in respect to the said gift of $3,327.50 reported by him.

The value of the right to receive income for life from the principal amount of each such gift in trust by a person of the same age as the beneficiary of that trust was stipulated by the Respondent (R 51-53; Exhibits 22-25 inclusive, R. 98-100) and in every instance the stipulated value of such right to receive income for life from the principal amount of the respective gift in trust was the same as the

amount of exclusion claimed under Section 1003(b) of the Internal Revenue Code of 1939 (subject to the $3,000.00 limitation contained therein) on account of such gift. Since the sole issue in controversy is whether said exclusions as claimed by the Donor are allowable in computing his net gifts for the years involved and since it has been agreed that no deficiencies or liabilities would result if this issue is decided in favor of the Petitioners (opinion of the Fourth Circuit Appendix, *Infra* at page 18), the value of each individual gift in trust made by the Donor in those years, the date on which such gift was made and the amount of exclusion claimed with respect thereto are not here repeated.

In his notices of deficiency (R. 21-27, 38-42) the Respondent stated that the exclusions claimed were disallowed "since they are gifts of future interests".

Upon argument in the Tax Court, the Respondent argued that the exclusions should be disallowed because under the provisions of Paragraph 3 of Article Fifth of each Trust Agreement, the income beneficiary of each trust could not have an absolute and immediate right to income for life since the corpus producing the income could be distributed at any time, in whole or in part, thereby cutting off income and even if the rights to receive trust income were present interests, there is no method of valuing such inerests (T.C. opinion, R. 15-16). Relying on earlier cases decided by it, the Tax Court sustained the Respondent on the valuation issue and in so doing stated:

> "It is provided in paragraph 3 of the fifth article of each trust agreement that the trustee may, in his absolute discretion, from time to time, make distribution from trust principal, in such amount as the trustee deems necessary or advisable for the following purposes: (1) To provide for the support, maintenance, care, or education of (a) the primary beneficiary, or

(b) of any member of his or her immediate family. (2) To provide for any illness or other emergency affecting (a) the primary beneficiary, or (b) any member of his immediate family. The purposes for which a trustee may make payments out of trust principal are broad and include the stated needs of not only the primary beneficiary but also of others, namely, any member of the primary beneficiary's immediate family. Under the provisions of paragraph 3, the trustee of each trust could in his sole and uncontrolled discretion, if the stated needs arose, diminish or wipe out the interest of the primary beneficiary in income of the trust by distributing part or all of the income-producing corpus. Under such trust provision, there is no known method for valuing the interest in trust income of the primary beneficiary, and petitioner has not found a method. The value of the interest in income cannot be determined in view of the power of the corpus of the trust at any time, and such distributions of corpus can be made for the benefit of individuals other than the primary beneficiary". (T.C. Opinion, R. 16)

The Fourth Circuit applied the same reasoning in affirming the opinion of the Tax Court.

The Petitioners did not below and do not here contend that a right to receive corpus of a trust in the future constitutes a present interest within the meaning of the Gift Tax Law. However, they do contend, and the Respondent concedes, that a right to receive the income from property constitutes a present interest. The Petitioners further contend that a power in the Trustees to make distributions out of corpus to or for the benefit of an income recipient, thereby reducing the interest of the corpus beneficiaries and converting *pro tanto* the interest of the income recipient from an equitable interest in the income only to a legal interest in the income and a legal interest in the corpus, does not have the effect of reducing the income recipient's

interest in the property or render the interest of the income recipient incapable of valuation or cause it to be anything other than a present interest in property for the purposes of the Federal Gift Tax Laws.

REASONS FOR GRANTING THE WRIT

1. *Conflict With Applicable Decisions of this Court*

The decision of the Tax Court and the Fourth Circuit in the present case totally disregards the principles established by this Court in the case of *Helvering v. Mary M. Hutchings, supra* and in the companion case of *United States v. Arthur Pelser, supra.* These decisions of this Court clearly establish the fundamental principle that Federal Tax Law is not concerned with distinction between legal title and equitable title or other "varying local definitions of property interests or with local refinements of conveyancing". These decisions further establish that gifts in trust are considered gifts to beneficiaries and not to the Trustees.

The rule which was followed by the Tax Court and the Fourth Circuit in the present case is based solely on the principle that "income received by an owner as the result of absolute ownership of property and income received by a trust beneficiary * * * are different in legal contemplation. The possibility of a future merger of the corpus and the right of income does not justify the conclusion that the value of the right to income is the same whether derived from the trust or from ownership because it ignores the distinction between income from ownership and income from a trustee to his beneficiary * * *". *La Fortune v. Commissioner of Internal Revenue*, (CA 10), 263 F. 2d 186 at 193; quoted *in extenso* in the opinion of the Fourth Circuit (Appendix *infra* at page 23.) This difference "in legal contemplation" between equitable interest and legal

interest is exactly what this Court said should not affect the application of the Federal Gift Tax Laws.

To hold that the interest of the income beneficiary cannot be valued, merely because the interest of the income beneficiary may be converted from an equitable interest to a legal interest, ignores the economic realities and ignores the principle that what is required to be valued is the interest of the beneficiary in the property which is transferred by the donor, without regard to whether that interest is equitable or legal or partially equitable or partially legal.

2. *Conflict with other decisions involving the valuation of rights to receive income.*

The basic question in this case is whether a power to distribute corpus to an income recipient can be regarded as having the effect of reducing the rights and interest of the income recipient. Both the Tax Court and the Fourth Circuit held that this power to grant increased benefits to the income beneficiary must be treated under the Federal Gift Tax Law as having the unusual effect of reducing the rights of the income beneficiary. This holding is in direct conflict with other decisions involving the valuation of rights to receive income.

The Tax Court in the case of *Albert E. Nettleton v. Commissioner*, 4 TC 987, held that a power to invade the corpus of a trust for the benefit of the life beneficiary thereof only results in the increase of his interest in the trust. That case involved the issue of the extent to which the value of a trust should be included in the estate of the grantor by reason of a reserved power in him to distribute the principal thereof to the income beneficiary. The Court held that only the remainder interests following the life estate of the income beneficiary were includible in the Decedent's

gross estate since such life estate was irrevocably vested in the income beneficiary and the "Decedent retained no power to *decrease* her interests. The power which he reserved to invade corpus could affect only the remainder interests". (Emphasis supplied by the Court.) The Court reached this conclusion on the grounds that during the lifetime of the income beneficiary corpus could be distributed only to her and, consequently, while rights to which the remaindermen might otherwise eventually become entitled could be taken away from them and given to the life beneficiary, there was no power to do the converse and take anything away from the life beneficiary. The Respondent acquiesced in the *Nettleton* case, 1946-1, C.B. 3.

Similarly, in the case of *J. J. Newlin v. Commissioner*, 31 T.C. 451, the Tax Court held that the value of the rights to receive income were not affected by the fact that the trust could be terminated and the entire corpus distributed to the income beneficiaries by the trustees with the consent of the beneficiaries.

3. *The rule applied by the Tax Court and the Fourth Circuit produces an illogical result and makes the application of the Federal Gift Tax laws dependent on technical property law distinctions.*

The rule followed by the Tax Court and the Fourth Circuit has been subject to vigorous criticism in dissenting opinions in the Tax Court because of the illogical nature of the conclusion that a power in a trustee to increase the rights of the holder of a present interest has the effect of reducing the value of such interest. See, for example, the dissent by Judge Turner in *Fred J. LaFortune v. Commissioner*, 29 T.C. 479, in which he stated:

> "I am unable to see how the size and amount of a gift of a right to receive currently the income from

> certain property for a stated period is in any way lessened or made indeterminable merely because, at the discretion of the trustee, the recipient of the gift of the right to income could at any time become the possessor and title owner of the income producing property itself."

Judge Forrester joined in this dissent. Similar statements were made by Judge Murdock in his dissent in *William Harry Kniep v. Commissioner*, 9 T.C. 943. Judge Leech joined in Judge Murdock's dissent.

The rule which was applied by the Tax Court and the Fourth Circuit in the present case is premised on the proposition that in order to sustain the exclusions it is necessary to value the right to receive the income from the transferred property while it is held in trust or, stated differently, that it is necessary to ascertain the present value of the trust income. See *William Harry Kniep v. Commissioner*, (CA 8th) 172 Fed. 2d 755 at 757-758, quoted in the Opinion of the Fourth Circuit (Appendix infra p. 21), and the portion of the Opinion of the Tax Court quoted at pages 9-10, *supra*, where it is stated that: "there is no known method of valuing the interest *in trust income* of the primary beneficiary". (Emphasis supplied.) This premise is contrary to the rules established by this Court in *Hutchins* and *Pelser*, *supra*, in which this Court established the fundamental principle that the gift tax law is concerned only with the question of what rights are actually acquired by the beneficiary and not with the question of whether these rights are technically rights to be exercised through a trustee, or rights to be exercised by an owner. Admittedly, any distribution of corpus to an income beneficiary will reduce to some extent the amount of income which will thereafter be received by the trust and which can thereafter be paid to the income beneficiary out

of the trust. However, such a reduction in the income which will be received by the trust is necessarily offset by the direct right of the income beneficiary to receive the future income from the distributed property as legal owner thereof.

At the time these trusts were created and at the time each addition to these trusts was made the income beneficiaries had the absolute and unconditional right to receive the income from the property transferred to the trust which was created for his or her particular benefit and the quantum of this right was in no way affected by the fact that the right might be exercisable in part as the beneficiary of a trust and in part as the legal owner of the corpus which had been distributed from the trust.

CONCLUSION

For the foregoing reasons, this Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit should be granted.

Respectfully submitted,

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APPENDIX

Opinion of United States Court Of Appeals for the Fourth District

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No. 7922.

On Petitions to Review the Decisions of the Tax Court of the United States.

(Argued November 5, 1959. Decided January 14, 1960.)

Before Soper and Boreman, Circuit Judges, and R. Dorsey Watkins, District Judge.

Mannes F. Greenberg (John W. Cable, III, and John S. McDaniel, Jr., on brief) for Petitioners, and Carolyn R. Just, Attorney, Department of Justice, (Charles K. Rice, Assistant Attorney General; Lee A. Jackson and Melva M. Graney, Attorneys, Department of Justice, on brief) for Respondent.

R. Dorsey Watkins, District Judge:

Question Presented

The Commissioner of Internal Revenue (Respondent) held that under the terms of certain trusts created by Raymond J. Funkhouser (hereinafter, Petitioner) $3,000 exclusions were not allowable under the Internal Revenue Code of 1930, 26 U.S.C. 1003, for each gift to such trusts by Petitioner in the years 1948, 1950, 1951, 1952 and 1953. The Tax Court affirmed.[1] We agree with the result reached by the Tax Court.

---

[1] T. C. Memo. 1958 — 222 (Harron, J.).

Position of the Parties

Petitioner over the years 1948, 1950, 1951 and 1953 established seventeen separate trusts for his five children and twelve grandchildren. Separate gifts were made to the various trusts in 1948, 1950, 1591, 1952 and 1953. As to each gift and each year, the Commissioner determined that no exclusions were allowable, since they were gifts of future interests. Petitioner and trustees under sixteen of the various trusts contend that a portion of each gift was of a present interest, namely, the gift of each beneficiary of an interest in trust income. Respondent counters that even were this so, there is no method of valuing such interest or right.

The deficiencies claimed relate only to alleged gift tax liability for the years 1952 and 1953. However, the gifts in prior years must be considered, because increases in the taxable amounts of the gifts in prior years will tend to increase the rate of gift tax applicable to 1952 and 1953.[2]

The case was tried in the Tax Court entirely upon stipulations.

The parties are in agreement that if the Tax Court is in error, none of the petitioners is liable for any gift tax. The parties have further agreed upon the extent of liability if the Tax Court is affirmed.[3]

Discussion

The trusts created by Petitioner are irrevocable, and are identical in terms except for designation of the respective beneficiaries. Article Fifth contains the critical provisions, which so far as relevant are as follows:

---

[2] The parties so agree, in view of Commissioner v. Disston, 1945, 325 U.S. 442, 446, 449, 65 S.Ct. 1328, 89 L.Ed. 1720.

[3] It is therefore not necessary to consider the fact that the 1948 gifts were reported under 26 U.S.C. 1000(f) as made one-half by petitioner and one-half by his wife. The underlying principle would not in any event be affected.

"1. For a period ending twenty-one (21) years after the death of the survivor of the Grantor's children . . ., or until the death of the last surviving descendant, if the same shall occur prior to the expiration of said period, the Trustees shall collect the dividends and interest from the trust fund, and . . . shall distribute and pay over the same forthwith as follows:

"(a) To . . . [the particular named initial income beneficiary] for and during [his or her] life; and after [his or her] death to [his or her] descendants living at the time of each payment in equal shares per stirpes and not per capita."

* * * * * *

"3. Nothwithstanding anything herein to the contrary provided, the Trustees are authorized in their absolute discretion from time to time to pay over to or expend on behalf of any person who is an income recipient hereunder at the time, such sum or sums from the principal of the Trust as they shall deem necessary or advisable to provide for any illness or other emergency affecting such person who is an income recipient hereunder at the time or any member of his or her immediate family, or to provide for the care, maintenance, support or education of such person or any member of his or her immediate family."

In each trust the trustees were thus given the absolute discretion to invade to the point of extinction the corpus of the trust, and thus destroy the interest of the initial income beneficiary in income to the extent of such invasion, not merely to provide for "any illness or emergency affecting" any "person who is an income recipient at the time . . . or to provide for the care, maintenance, support or education of such person"; but the same right was given, for the same purposes, with respect to "any member of his or her immediate family." There is no evidence in the record that the use of corpus for either class was so remote as to be negligible.

The Internal Revenue Code of 1939 (26 U.S.C.) provides:

"Sec. 1003. Net Gifts.

"(a) *General Definition.* — The term 'net gifts' means the total amount of gifts made during the calendar year, less the deductions provided in section 1004.

"(b) *Exclusions from Gifts.*

* * * * * *

"3. [as added by Sec. 454 of the Revenue Act of 1942, c. 619, 56 Stat. 953] *Gifts after 1942.* — In the case of gifts (other than gifts of future interests in property) made to any person by the donor during the calendar year 1943 and subsequent calendar years, the first $3,000 of such gifts to such person shall not, for the purposes of subsection (a), be included in the total amount of gifts made during such year."

It was conceded that the interests of the beneficiaries in the principal of the trusts were future interests, for which no exclusion is allowed. It was further agreed that the unqualified right to receive income for life or other ascertainable periods is a present interest. But where the taxpayer claims an exclusion of a present interest:

> "The taxpayer claiming the exclusion must assume the burden of showing that the value of what he claims is other than a future interest . . ." Commissioner v. Disston, 1945, 325 U.S. 442, 449, 65 S. Ct. 1328, 89 L. Ed. 1720.

The "right" of the income beneficiaries to receive income was dependent upon the existence and amount of a corpus from which the income was to be derived. There was no certainty as to duration, or amount. The corpus of any trust could have been reduced at any time, in any amount (with corresponding reduction of income productivity), not simply for the needs of an income beneficiary but for those of any member of his or her immediate family.

Petitioners' contention that their income interests should be valued as life estates[4] because their interests could only be increased, as distinguished from decreased, by distributions of corpus, is without merit.

Under the trusts, no beneficiary had any life interest in the income from any ascertainable amount of corpus. That corpus could be reduced or wiped out at any time. Such reduction or elimination could be on behalf not only of the income beneficiary, but of any member of his or her immediate family. Further, to the extent that any distribution (whether directly to or for the income beneficiary or on behalf of a member of his or her immediate family) could be considered an increase in the income beneficiary's income interest, this would come from corpus, and the gifts of corpus admittedly were gifts of future interests, excluded in valuing the beneficiary's interest in income when the trust was created.

The principles of the decided cases support the foregoing conclusions, and the decision of the Tax Court.

In Kniep v. Commissioner, 8 Cir. 1949, 172 F. 2d 755, a trust provided for the payment currently to the beneficiaries of the trust income, and a proportionate share of the corpus was to be distributed to each upon arrival at the age of sixty years. The trustees were authorized to use corpus up to $1,000 for the proper maintenance and support of, or to provide against any emergency encountered by, any beneficiary. The court approved the Commissioner's computation of the present worth of the gifts of income on the basis of a trust corpus reduced by the maximum permitted invasion, saying (pp. 757-758):

> ". . . The argument [of the taxpayer] is that, if article V is to be given any effect in the determination of the amount of exclusions allowable under section 1003 (b)(3), the necessary result would be to increase

[4] The stipulation contains computations of the "Value of the right to receive income for life from and after December 30, 1950, *from property of stated value*." (Emphasis supplied.)

rather than to diminish the present worth of the gifts of present interests. . . ."

* * * * * *

". . . The taxpayer has the burden of proving not only his right to the claimed exclusion, but also the amount of it. *Commissioner v. Disston, supra*, 325 U.S. at page 449, 65 S. Ct. at page 1331, 89 L. Ed. 1720, 158 A.L.R. 166. The insuperable difficulty with which the petitioner is confronted is that it is impossible for him to prove that the principal of the trust estate, and thus the income from it, will not be decreased by the exercise of the discretionary power of invasion granted to the trustees; or to prove the amount by which the principal, upon which the present worth of the right to receive income must be computed, may be reduced by the exercise of the trustees' power of invasion."

On the contention there made, as here, that any distribution must enlarge the income beneficiary's interest, the court said (p. 757):

". . . the right to receive principal through the power of the trustees to invade it is a future interest . . ."

In Evans v. Commissioner, 3 Cir. 1952, 198 F. 2d 435, trust income was currently payable to each child of the donor for life, the trustees being given uncontrolled discretion to use such amount of principal as they deemed necessary for the education, comfort and support of such child, or the spouse or children of such child. The trust also authorized each child after reaching thirty years of age to withdraw principal not exceeding $1,000 each year. Relying upon Sensenbrenner v. Commissioner, 7 Cir. 1943, 134 F. 2d 883 and Fisher v. Commissioner, 9 Cir. 1942, 132 F. 2d 383, the court denied the claimed exclusions for the right to trust income, saying (198 F. 2d at 437):

"In brief, the terms of the present trust enable us to ascribe a minimum combined value to the present and future interests of each beneficiary. But we cannot

ascertain their values separately. Neither are we justified, for gift tax purposes, in treating them as if merged into a single present interest. The donor expressly divided the rights of each beneficiary into those of present and those of future enjoyment and must, accordingly, accept the tax consequences of that division."

In Herrmann's Estate v. Commissioner, 5 Cir. 1956, 235 F. 2d 440, the donor had created irrevocable trusts for his minor grandchildren, providing for the distribution of the annual net income, and authorizing the trustee to distribute to each beneficiary any or all of the corpus to the extent deemed necessary or advisable for the education, maintenance and support of the beneficiary. The trusts were to terminate as to each beneficiary upon reaching the age of twenty-five years. The court pointed out the two-fold nature of the transaction: one an interest in income, the other in principal. The gifts of principal were clearly future. Although the requirement to pay income annually was unconditional, the authorized reductions of principal made it impossible to assign a present value to the income interest. The court said (pp. 444-445):

". . . Where, as here, the trustee is authorized to distribute all or any part of the principal, the distribution, be it little or much, would result in a ratable reduction in the trust income and a proportional reduction in the income producing potential of the trust res. Since it cannot be known, at the creation of the trust, what part, if any, of the trust principal will be distributed, or when, if ever, any principal distributions will be made, there is no basis or formula by which the future interest can be valued, and the taxpayers are unable to meet the burden imposed on them to establish a value."

In La Fortune v. C.I.R., 10 Cir. 1958, 263 F. 2d 186, the power of the trustee to terminate the trust at any time the trustee deemed it for the best interest of the beneficiary and to distribute it to him, was held to make it im-

possible to value the income interest. Petitioner again advanced the argument that accelerated termination of the trust could not change the size or value of the present right to income. It was again rejected.

The court said (pp. 192-194):

"The value of a present right to income given in trust is calculated by multiplying the expected annual return by the probable period over which it will be paid. In the case of the 1951-2 gifts the probable period over which the income will be paid is uncertain because the trustee has the discretionary right of termination. An integral element of the formula is unknown.

". . . Appellants rely on the theory of the Tax Court dissents. It is argued that the accelerated termination of the trust can only have the effect of investing the beneficiary with the title to the corpus and cannot change the size or value of the present right to income. As heretofore noted separate consideration must be given to the gift of the corpus and to the gift of the income. A separate valuation of each is necessary. The theory that the valuation of the right to income is not affected by the circumstance of an accelerated distribution of principal overlooks the difference between income received by an owner as the result of absolute ownership of property and income received by a trust beneficiary as the result of payments to his trustee from the proceeds of trust investments. The two are different in legal contemplation. The possibility of a future merger of the corpus and the right to income does not justify the conclusion that the value of the right to income is the same whether derived from the trust or from ownership because it ignores the distinction between income from ownership and income from a trustee to his beneficiary. . . ."

". . . We conclude that the Tax Court correctly held that the rights to income under the 1951-2 gifts were incapable of valuation and hence were not subject to the claimed exclusion."

The decision of this court in United States v. Baker, 4 Cir. 1956, 236 F. 2d 317, is not to the contrary. There, trusts were created for the donors' minor grandchildren, "the net income and principal" to be used for the support; education and benefit of each beneficiary "in such amounts and manner and at such times as shall be in accordance with the needs and bests interests of the beneficiary and as if the Trustee herein were holding the properties as Guardian of the beneficiary and making distributions of the properties in that capacity for the needs and benefit of the beneficiary. It is the intention of the Grantor to make, and the Grantor does hereby make, an immediate and present gift to the beneficiary of the use and benefit of the properties."

The trust agreement also provided for distribution of "all properties not used for the aforesaid purposes" to each beneficiary on the twenty-first anniversary of his birth, and further provided that if he should die before that time the trust property should pass as part of the beneficiary's estate, excluding the donor.

The trust agreement was to be construed and the trust estate administered under the laws of North Carolina. The Commissioner disallowed the claimed exclusions on the grounds that the gifts were of future interests. The appellees paid the deficiences so determined, claims for refunds were filed and denied, and suit was instituted in the district court which entered judgment for the appellees, which judgment was confirmed on appeal.

After mentioning that "[a]lthough not controlling, it is of some significance that the donor . . . expressed his intention to make 'an immediate and present gift to the beneficiary' ", this court pointed out that "It was conceded by appellant in argument that an outright gift by a donor to the guardian of a minor would be the gift of a present and not a future interest under the terms of the statute." The trust agreements not only created no barrier to the present enjoyment by the infants of the trust funds beyond those established by the laws of North Carolina, but in fact removed certain of those barriers, since the trustee, although

empowered to deal with the funds as if a guardian, was not, as a guardian would be, under North Carolina law, required to secure the approval of any court.

> ". . . Here the right of the beneficiaries to present enjoyment of both the corpus and the income is not different from what it would be if the gifts had been made directly to each of them [the infant beneficiaries], or to a guardian for their benefit. There is no magic in mere words. These gifts to a trustee, since they conferred on the beneficiaries the same right to present enjoyment which they would have had if the gifts had been made to a guardian for them, must be judged by the same standard as that applied to gifts made to a guardian." (236 F. 2d at p. 320).
>
> * * * * * *
>
> "We believe that the gifts made by appellees were equivalent to outright gifts by them to the infant beneficiaries . . ." (p. 321).

The other citations of petitioners have also been considered, but they are likewise inapposite. Where a present right, although based upon a contingency (remarriage of a widow) is actuarily determinable, Du Charme's Estate v. Commissioner, 6 Cir. 1947, 164 F. 2d 959, Commissioner v. Maresi, 2 Cir. 1946, 156 F. 2d 929, such value should be recognized.

Newlin v. Commissioner, 31 T.C. 451, decided slightly more than one month before the decision of the Tax Court herein, is not inconsistent with that decision. In the Newlin case, the present interests in income were terminable only with the consent of the trustees and all living beneficiaries. This veto power was, understandably, held to justify treating the life income interests as susceptible of valuation.

For the foregoing reasons, the decisions of the Tax Court are

Affirmed.

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[5] Our problem and function is not to reconcile, criticize or review all decisions of the Tax Court, but only to determine the validity, vel non, of the particular decision under review.

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No. 858

In the Supreme Court of the United States

OCTOBER TERM, 1959

RAYMOND J. FUNKHOUSER, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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OPINIONS BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 8–17) [1] are not officially reported. The opinion of the court of appeals (Pet. 17–26) is reported at 275 F. 2d 245.

JURISDICTION

The judgment of the court of appeals was entered January 14, 1960 (Pet. 17). The petition for a writ of certiorari was filed on April 12, 1960. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

The taxpayer-donor made gifts in 1948 and subsequent years to seventeen trusts under each of which

[1] Record references are to the appendix to the taxpayer's brief in the court of appeals.

the trustees were required to distribute the trust income annually to the beneficiary and had full discretion to distribute all or a part of the corpus at any time to provide for any illness or emergency or for the care, maintenance, support or education of the income beneficiary or of any member of the beneficiary's immediate family. The question is whether the court below erred in holding that for gift tax purposes the income interests of the beneficiaries could not be valued because of the trustees' power to disburse trust corpus and, accordingly, that the taxpayer-donor is not entitled to exclusions for gifts of present interests under Section 1003(b)(3) of the Internal Revenue Code of 1939.

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code of 1939:

> SEC. 1003. NET GIFTS.
>
> (a) *General Definition.*—The term "net gifts" means the total amount of gifts made during the calendar year, less the deductions provided in section 1004.
>
> (b) *Exclusions from Gifts.*
>
> * * * * *
>
> (3) [as added by Sec. 454 of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Gifts after 1942.*—In the case of gifts (other than gifts of future interests in property) made to any person by the donor during the calendar year 1943 and subsequent calendar years, the first $3,000 of such gifts to such person shall not, for the purposes of subsection (a), be included in the total amount of gifts made during such year.

(26 U.S.C. (1952 ed.) 1003)

Treasury Regulations 108, promulgated under the Internal Revenue Code of 1939:

> Sec. 86.10 *Total Amount of Gifts.*—Except with respect to any gift of a future interest in property, the first $3,000 of gifts made to any one donee during the calendar year 1943 or during any calendar year thereafter shall be excluded in determining the total amount of gifts for such calendar year. In the case of a gift in trust, the beneficiary of the trust is the donee of the gift. * * * The entire value of any gift of a future interest in property, * * * must be included in the total amount of gifts for the calendar year in which such a gift is made.
>
> Sec. 86.11 [as amended by T.D. 5902, 1952–1 Cum. Bull. 167] *Future Interests in Property.*—No part of the value of a gift of a future interest may be excluded in determining the total amount of gifts made during the calendar year. "Future interests" is a legal term, and includes reversions, remainders, and other interests or estates, whether vested or contingent, and whether or not supported by a particular interest or estate, which are limited to commence in use, possession, or enjoyment at some future date or time. The term has no reference to such contractual rights as exist in a bond, note (though bearing no interest until maturity), or in a policy of life insurance, the obligations of which are to be discharged by payment in the future. But a future interest or interests in such contractual obligations may be created by the limitations contained in a

trust or other instrument of transfer employed in effecting a gift. For the valuation of future interests, see section 86.19(f) or 86.19(g), whichever is applicable.

STATEMENT

The taxpayer created seventeen separate trusts for his five children and twelve grandchildren between 1948 and 1953, to which he gave shares of stock of Victor Products Corporation and Funkhouser Industries, Inc. (R. 9–10). All of the Funkhouser trusts are irrevocable. They are to terminate twenty-one years after the death of the survivor of the donor's children or, if said death shall occur prior thereto, upon the death of the last surviving descendant of the donor. Upon termination, the trust fund as then constituted is to be paid and distributed to the persons who were entitled to receive trust income immediately prior to the termination of the trust. The fifth article of each trust provides that during the term of the trust the trustees are to pay all of the net income each year to the primary and initial beneficiary during his or her life and, after the death of such beneficiary, to his or her descendants, if any, or, if none, then to other designated beneficiaries (Pet. 18–19; R. 10–11). Paragraph 3 of the fifth article provides (Pet. 19; R. 11):

> 3. Notwithstanding anything herein to the contrary provided, the Trustees are authorized in their absolute discretion from time to time to pay over or to expend on behalf of any person who is an income recipient hereunder at the time, such sum or sums from the principal

> of the Trust as they shall deem necessary or advisable to provide for any illness or any emergency affecting such person who is an income recipient hereunder at the time or any member of his or her immediate family, or to provide for the care, maintenance, support or education of such person or any member of his or her immediate family.

The taxpayer-donor claimed a total of sixty-four exclusions for gifts of present interests in his gift tax returns for 1948 and 1950 through 1953. The Commissioner determined that no exclusions were allowable because the gifts were of future, rather than present, interests within the meaning of Section 1003(b) of the Internal Revenue Code of 1939[2] (R. 12–13).

The Tax Court upheld the Commissioner's deficiency determinations, holding that the gifts of a present right to receive trust income could not be valued for gift tax purposes because of the trustees' discretion to disburse the corpus and that, therefore, the taxpayer-donor is not entitled to exclusions for gifts of present interests under Section 1003(b)(3) of the Internal Revenue Code of 1939 (R. 14–17). The court of appeals affirmed (Pet. 17–26).

ARGUMENT

The decision below is correct and is in accord with the decisions of four other circuits which previously determined the same basic issue. There is thus no

[2] The trusts and trustees are parties only because transferee liability was asserted against them (R. 14). In the court below, transferee liability was conceded in the event the decision of the Tax Court was sustained.

conflict of decisions or other reason warranting further review by this Court.

1. Section 1003(b)(3) of the Internal Revenue Code of 1939 (*supra*, p. 3) authorizes the exclusion of the first $3,000 of each gift to another person in a calendar year in determining the amount of net gifts (see Section 1003(a), *supra*, p. 3) on which gift tax is imposed by Section 1001 (26 U.S.C. (1952 ed.) 1001), provided the gift is not of a future interest—that is, an interest which is limited to commence in use, possession, or enjoyment at some future time. *Commissioner* v. *Disston*, 325 U.S. 442; *Fondren* v. *Commissioner*, 324 U.S. 18; see also *Ryerson* v. *United States*, 312 U.S. 405; *United States* v. *Pelzer*, 312 U.S. 399; *Helvering* v. *Hutchings*, 312 U.S. 393. For the statutory exclusion to be applicable, "[t]he taxpayer claiming the exclusion must assume the burden of showing that the *value* of what he claims is other than a future interest" (emphasis added). *Commissioner* v. *Disston*, *supra*, 325 U.S. at 449; see also Rev. Rul. 54–92, 1954–1 Cum. Bull. 207.

In the present case it is conceded that the interests of the beneficiaries in trust corpus are future interests (Pet. 10, 20). On the other hand, the beneficiaries' present rights to receive trust income are present interests for which exclusions are allowable if the interests are such that they can be valued. The income interests of the beneficiaries, however, are interests attaching to trust corpus which can be reduced and even wiped out by exercise of the trustees' discretion to disburse corpus. Since the beneficiaries had no interest in the income from any ascertainable

amount of corpus, it is apparent, and conceded by the taxpayer, that the present income interest could not be valued separate and apart from the future interests.

The taxpayer contends (Pet. 12–13, 14–15), nevertheless, that the income interests should be valued as life estates on the theory that exercise of the trustees' discretion would only result in increasing, rather than decreasing, the beneficiaries' interests. This approach disregards the fact, first of all, that trust corpus could be distributed by the trustees not just for an income beneficiary's benefit but for the benefit of any member of his or her immediate family. It is not necessarily true, therefore, that the income beneficiary's interest could only be increased by exercise of the trustee's discretion. Aside from that, the taxpayer's approach assumes that a portion of the value of the future interests (*i.e.*, the corpus) may be attributed to the present income interests to support valuation of the latter. This assumption is directly contrary to the well-established rule that no exclusion is allowable in respect of any part of the value of future interests.

2. Even prior to the decision below, the position taken by this taxpayer had already been consistently rejected by the courts. The Third, Fifth, Eighth, and Tenth Circuits had all held that the possibility of reduction or destruction of trust principal, even if solely for the benefit of the income beneficiary, renders impossible any ascertainment of the present worth of a gift of trust income and therefore precludes allowance of the statutory exclusion. *La Fortune* v. *Commissioner*, 263 F. 2d 186 (C.A. 10); *Herrmann's*

Estate v. *Commissioner*, 235 F. 2d 440 (C.A. 5); *Evans* v. *Commissioner*, 198 F. 2d 435 (C.A. 3); *Kniep* v. *Commissioner*, 172 F. 2d 755 (C.A. 8); see also *Brody* v. *Commissioner*, 19 T.C. 126. If this established rule seems "illogical," as the taxpayer asserts (Pet. 13), it is because Congress chose to draw a line between the value of gifts of future interests and of present interests.

The taxpayer is in error in asserting (Pet. 11–12) that the decision below is in conflict with this Court's decisions in *Helvering* v. *Hutchings*, 312 U.S. 393, and *United States* v. *Pelzer*, 312 U.S. 399. The sole holding in the *Hutchings* case was that, in the case of a transfer of property for the benefit of numerous beneficiaries, the statute allows an exclusion for the gift to each beneficiary rather than but one exclusion for a gift in trust, assuming that the gifts are not of future interests. In the *Pelzer* case, this Court made a similar holding and, in addition, concluded that under one of the trusts the gifts were of future, rather than present, interests. These decisions also state that the gift tax provisions are not concerned with the mere transfer of legal title (*Hutchings*) or with local law definitions of future interests (*Pelzer*), but those principles are not in any way involved in the present case.

Contrary to the taxpayer's assumption (Pet. 11–12, 14), the decision below does not rest on a distinction between equitable and legal ownership of property. The court below held that the income interest could not be valued because (1) the corpus of each trust could be reduced or eliminated through distribution for the benefit

of not only the income beneficiary but any member of his or her immediate family and (2), while a distribution for the benefit of the income beneficiary would increase his entire interest, the distribution would come from the corpus, which was admittedly a future interest and would reduce the present income interest (Pet. 21).[3]

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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MAY 1960.

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[3] The Tax Court decisions cited by the taxpayer (Pet. 12–13) as being in conflict with the decision below are also distinguishable from the present case. *Estate of Nettleton* v. *Commissioner*, 4 T.C. 987, involved the valuation of a transfer in trust in an estate tax, not a gift tax, context and presented no problem in relation to distinguishing between the value of present and future interests. *Newlin* v. *Commissioner*, 31 T.C. 451, which was decided only a little more than a month before the Tax Court decision here, is somewhat similar to the present case but is distinguishable because the income interests of the beneficiaries were terminable only with the consent of the trustees and all living beneficiaries. Thus, each beneficiary had what amounted to a right to veto a proposed termination.

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